

Message Text

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ACTION EB-11

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TAGS: ERNG, BE

SUBJECT: SHELL OIL PAPER ON PRICES

1. AT INFORMAL ECG PREPCON WILLIAM (UK) CIRCULATED PAPER
HE SAID PREPARED BY SHELL OIL COMPANY TO STRESS TO
GOVTS IMPORTANCE OF AVOIDING OPEC ACTION IN QUITO
WHICH WOULD RAISE OIL PRICES SUBSTANTIALLY IN GUISE
OF ATTEMPTING REDUCE COMPANY PROFITS. PAPER FOLLOWS
MINUS DETAIL; COMMENTS SEPTEL: BEGIN QUOTE:

"OIL PRICES

ARAB OIL AND GAS PUBLISHED AN ARTICLE ON 16 MAY
1974 IN WHICH THE OPEC ECONOMIC COMMISSION'S PROPOSAL
FOR TAXING THE 'EXCESSIVE' PROFITS OF OIL COMPANIES
WAS DESCRIBED. THIS HAS SINCE RECEIVED FAIRLY WIDE
PUBLICITY AND SPECULATION THAT THE PROPOSALS WILL BE
ACCEPTED BY OPEC AT THEIR QUITO CONFERENCE ON 15 JUNE.

"1. THE ECONOMIC COMMISSION PROPOSAL IS TO CHANGE THE
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TAX RATE FROM 55 PERCENT TO 87 PERCENT. THE PURPOSE

OF THIS IS TO RAISE THE TAX PAID COST OF COMPANY'S EQUITY OIL FROM 7 DOLLARS 10 CENT (ARAB LIGHT MARKER CRUDE) TO 10 DOLLARS 34 CENT, AND THUS TO GIVE OIL COMPANIES A MARGIN ON THEIR EQUITY CRUDE OF 50 CENT, I.E. THE DIFFERENCE BETWEEN 10 DOLLARS 34 CENT AND 10 DOLLARS 84 CENT WHICH IS ASSUMED AS THE 'REALISED' PRICE (93 PERCENT OF POSTING, ALSO ASSUMED EQUIVALENT TO BUYBACK PRICE).

"2. THIS ASSUMES THAT THE OIL COMPANIES ARE SELLING OIL AT THE BUYBACK PRICE OR HIGHER. THIS IS NOT THE CASE. SELLING PRICES ARE IN FACT NEGOTIATED USING AN AVERAGE COST INGREDIENT (AVERAGE OF EQUITY AND BUYBACK OIL), SO THAT THE RELATIVELY HIGH MARGIN ON EQUITY CRUDE IS OFFSET BY A COMPARABLE LOSS ON BUYBACK CRUDE.

"3. IF THE ECONOMIC COMMISSION PROPOSALS WERE TO BE ADOPTED, THE EFFECT WOULD BE TO RAISE THE AVERAGE COST OF OIL BY WELL OVER 1 DOLLAR/BBL.

"4. WHETHER OR NOT THE OPEC CONFERENCE ITSELF WILL ADOPT THE PROPOSAL CANNOT BE KNOWN. HOWEVER, SINCE A FURTHER INCREASE IN THE COST OF OIL OF THIS MAGNITUDE COULD HAVE FAR-REACHING EFFECTS, IT WOULD SEEM DESIRABLE THAT CONSUMER GOVERNMENTS ARE AWARE OF THE SITUATION.

"IT IS RECOGNISED THAT OPEC IS ALREADY STUDYING THE QUESTION OF HOW TO ESTABLISH IN THE LONGER TERM A FAIR PRICE FOR OIL, FOR INSTANCE BY REFERENCE TO ALTERNATIVE ENERGY COSTS, AND THIS OR SOME OTHER SYSTEM MAY LEAD TO A RATIONAL FORMULA IN THE FUTURE. "AT THE MOMENT SUCH STABILITY AS THERE IS IN THE CRUDE OIL MARKET IS PROVIDED BY THE CAPABILITY OF INTEGRATED COMPANIES TO USE AVERAGE COSTS FOR THEIR CRUDE SALES. THIS MEANS THAT THERE IS STILL A LARGE VOLUME OF OIL MOVING INTERNATIONALLY AT PRICES CONSIDERABLY LOWER THAN THE SPOT MARKET, AND THAT THE SPOT MARKET - ESSENTIALLY A VOLATILE MARKET WHICH ANSWERS TO PARTICULAR STRESSES OF SUPPLY AND DEMAND - DOES NOT VIOLENTLY AFFECT THE MAINSTREAM MARKET.

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THIS RELATIVE STABILITY IS OF VITAL IMPORTANCE TO CONSUMERS AND, UNDER PRESENT CONDITIONS, EXISTS BECAUSE OF THE LARGE COST DIFFERENTIAL BETWEEN EQUITY AND BUYBACK CRUDE. IF THIS DIFFERENTIAL WERE TO BE REMOVED, A SIGNIFICANT DANGER WOULD BE THAT THE TOTAL MARKET WOULD BE SUBJECT TO THE VOLATILITY AND INSTABILITY OF THE MARGINAL MOVEMENTS IN THE SPOT MARKET. "TO MAINTAIN THIS DIFFERENTIAL IMPLIES INACTION BY

OPEC ON TAX RATES AS THEY APPLY TO EQUITY OIL. IT IS WELL UNDERSTOOD THAT BY GIVING SUCH ADVICE AT THIS PRESENT JUNCTURE, THE COMPANIES WOULD APPEAR TO BE SEEKING THE PERPETUATION OF A SYSTEM THAT BENEFITS THEM. HOWEVER, THE FACT IS THAT THIS COST BENEFIT IS PASSED ON TO CONSUMERS IN LOWER PRICES, AS IS WELL KNOWN TO CONSUMER GOVERNMENTS AND MUST EQUALLY BE KNOWN TO PRODUCER GOVERNMENTS.

"IT WOULD BE FAIR TO SAY THAT THE COMPANIES WOULD GENERALLY WELCOME AN ALTERNATIVE SYSTEM OF PRICING CRUDE THAT REMOVED THE LARGE DIFFERENTIAL BETWEEN COSTS OF EQUITY AND BUYBACK OIL, BUT BELIEVE THAT ANY SUCH SYSTEM:

- A) SHOULD NOT HAVE THE EFFECT OF INCREASING THE AVERAGE COST OF OIL;
- B) SHOULD BE DEVELOPED ON A BASIS THAT WILL GIVE SOME STABILITY AND RATIONALE TO PRICES;
- C) SHOULD MAINTAIN OR ENCOURAGE THE INTEREST OF THE COMPANIES IN THE OPERATIONS AND INVESTMENT IN WHATEVER WAY IS MUTUALLY AGREED WITH THE PRODUCER GOVERNMENTS.
"IT WOULD SEEM THAT THIS, TOGETHER WITH THE RELATED QUESTIONS OF LEVELS OF OIL SUPPLY AND DISCUSSION ON THE ASPIRATIONS OF THE PRODUCERS FOR INDUSTRIALISATION AND DIVERSIFICATION OF THEIR ECONOMIES IS THE PROPER SUBJECT FOR THE DIALOGUE WHICH MUST IN THE END TAKE PLACE BETWEEN ALL THE INTERESTED PARTIES." END QUOTE.
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